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Supreme Court, U. S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1972

No. 72-705

FIRST STATE BANK OF CROSSETT, ARKANSAS,
Petitioner,

vs.

UNITED STATES OF AMERICA, T. C. TRIGG,
OVID SWITZER and VICTOR SCOTT,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals
For the Eighth Circuit

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INDEX

	Page
Judgment of Lower Court	1
Jurisdiction to Grant Writ	2
Questions Presented for Review	2
Federal and State Statutes Involved	2
Jurisdiction of the Federal District Court	4
Statement of the Case	5
Reasons for Granting Writ	8
Conclusion	9
Appendix:	
Opinion of the Court of Appeals for Eighth Circuit	A-1
Opinion of the United States District Court, Western District of Arkansas, El Dorado Division	A-15
Judgment of the United States District Court	A-33

CITATIONS

Cases

Anderson v. First Jacksonville Bank, 243 Ark. 977, 423 S.W.2d 273	9
In Re Halprin, 280 Fed. (2) 407	8,9
Monroe Bank and Trust Co. v. Allen (Miss.), 286 F. Supp. 201	8
Union Life Ins. Co. v. Perkins (Ark.), 257 F. Supp. 154	8
United States v. Bess, 357 U. S. 51, 78 S. Ct. 1054	8,9
United States v. Lester (N. Y.), 235 F. Supp. 115	8,9

Statutes

28 USC § 1254 (1) 2
28 USC § 2101 (c) 2
28 USC § 7426 4
28 USC § 6321 2,9
Ark. Stats, 1947, Ann. 85-9-201 3
Ark. Stats, 1947, Ann. 85-9-202 3
Ark. Stats., 1947, Ann. 85-9-301 3

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PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals
For the Eighth Circuit

Comes now the petitioner, First State Bank of Crossett, Arkansas and for its petition for writ of certiorari states:

JUDGMENT OF LOWER COURT

The judgment of the United States Court of Appeals for the Eighth Circuit dated and entered on August 17, 1972, is contained in ... Fed. 2d ..., and a copy of said opinion is appended hereto. The memorandum opinion of the United States District Court, Western District of Arkansas, El Dorado Division, which is not reported, is ap-

pended. The judgment of the United States District Court dated July 6, 1971, based on said memorandum opinion, is also set forth in the appendix.

JURISDICTION TO GRANT THE WRIT

The jurisdiction to grant this writ is based on 28 USC 1254 (1) and 28 USC 2101 (c).

QUESTIONS PRESENTED FOR REVIEW

1

Does a taxpayer have "property" or "rights to property" in accounts receivable, validly assigned by the taxpayer to a third party?

2

Does a Federal Tax Lien, under Title 26, Section 6321, attach to an account receivable validly assigned by the taxpayer.

3

Does the Uniform Commercial Code adopted in Arkansas in 1961, giving certain rights to "lien creditors" as against an unperfected security interest, enlarge the rights of the United States so that assigned accounts can be reached by the United States under a tax lien, even though under Arkansas law the debtor no longer has "property" nor "rights to property" therein.

FEDERAL AND STATE STATUTES INVOLVED

The statutes involved are:

26 USC 6321—"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount,

additional to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

Ark. Stats., 1947 Ann., Vol. 7C, § 85-9-201, Page 362—"General validity of security agreement.—Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article [chapter] validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail instalment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto."

Ark. Stats., 1947 Ann., Vol. 7C, § 85-9-202, Page 363—"Title to collateral immaterial—Each provision of this Article [chapter] with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor."

Ark. Stats, 1947 Ann. Vol. 7C, §85-9-301, Page 371—"Persons who take priority over unperfected security interests—'Lien creditor.'—(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9-312 [§85-9-312];

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in

ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts, contract rights, and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten [10] days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A 'lien creditor' means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest."

JURISDICTION OF THE FEDERAL DISTRICT COURT

Jurisdiction in the United States District Court for the Western District, El Dorado Division, was established under Title 26, USC §7426.

STATEMENT OF THE CASE

This action was brought against the United States by T. C. Trigg, et al., and First State Bank of Crossett, Arkansas, to recover sums of money collected by the United States under alleged wrongful levies upon the proceeds due under construction contracts between Sutton Construction Company, Inc., and the City of Hope, Arkansas, and between Sewer Improvement District No. 2 of McGehee, Arkansas and Sutton Construction Company, Inc.

All the facts were stipulated.

Sutton Construction Company entered into a contract with the City of Hope for the construction of a sanitary water and storm sewer improvement for a contract price of $112,435.16 on August 14, 1968.

On June 17, 1968, Sutton Construction Company entered into a contract with Sewer Improvement District No. 2 of McGehee, Arkansas for the construction of a sanitary water and storm sewer improvement for the total price of $164,418.76.

On August 2, 1967, Sutton Construction Company, Inc. executed an accounts receivable security agreement which assigned to First State Bank of Crossett, Arkansas, all of Sutton Construction Company, Inc.'s accounts receivable which thereafter came into existence and all the proceeds of existing and future accounts receivable. The security agreement, therefore, contained an assignment of all accounts receivable of Sutton Construction Company, Inc.

In addition, on November 1, 1968, Sutton Construction Company, Inc. directed Sewer Improvement District No. 2 of McGehee, Arkansas, to make all payments to become due to Sutton Construction Company, Inc. under the con-

tract of June 17, 1968, jointly to Sutton Construction Company, Inc. and First State Bank of Crossett, Arkansas. On December 13, 1968, a similar direction in writing was given to the City of Hope, Arkansas, with regard to payments to be made under its contract of August 14, 1968. Subsequent thereto, both Sewer Improvement District No. 2 of McGehee, Arkansas, and the City of Hope acknowledged receipt of the letters from Sutton Construction Company, Inc. and agreed to issue payments under the contract as requested therein.

The moneys advanced by the First State Bank of Crossett, Arkansas were used to pay labor and furnish materials for the actual performance of the two contracts in question and said advances enabled Sutton Construction Company, Inc. to perform said contracts to the extent performed and enabled Sutton Construction Company, Inc. to earn the progress payments involved in this case.

Since the execution of the August 2, 1967 accounts receivable security agreement, Sutton Construction Company, Inc. has been continuously indebted to the First State Bank of Crossett, Arkansas, and at all times in an amount in excess of $13,919.41. All advances were made by the First State Bank of Crossett, Arkansas, specifically relying on the security agreement of August 2, 1967, and the written directions given the City of Hope, Arkansas, and Sewer Improvement District No. 2 of McGehee, Arkansas, to issue the checks for progress payments jointly to the First State Bank of Crossett, Arkansas and Sutton Construction Company, Inc.

The balance owing to the First State Bank of Crossett, Arkansas is $15,282.64 under advances made on February 21, 1969, and March 3, 1969; but at all times since August 2, 1967, Sutton Construction Company, Inc. was indebted

to First State Bank of Crossett, Arkansas in amounts in excess of $13,919.41.

Notice of federal tax liens were filed on January 15, 1969, and on February 12, 1969, with the Circuit Clerk, Ashley County, Arkansas, for assessments of December 30, 1968, and February 7, 1969.

Under these assessments, the United States served notice of levy upon the Sewer Improvement District No. 2 of McGehee, Arkansas, and on April 21, 1969, received $10,763.59 due under the contract of August 14, 1968, as an estimated progress payment for work performed between February 11, 1969, and March 1, 1969.

On March 8, 1969, the United States served notice of levy upon the City of Hope and received the sum of $8,336.16 due under the contract of June 17, 1968, as an estimated progress payment for work performed between February 1, 1969, to March 7, 1969.

Subsequent to said payments, Sutton Construction Company, Inc. defaulted under the contract with the City of Hope, Arkansas, on or about April 13, 1969, and sometime late in April, Sutton Construction Company, Inc. defaulted on its contract with Sewer Improvement District No. 2 of McGehee, Arkansas, but no written notice of said default was given by said Sewer Improvement District.

The United States claims these progress payments by reason of its tax liens and tax levies, the First State Bank of Crossett, Arkansas, claims the funds by reason of the assignment to it of said funds.

REASONS FOR GRANTING THE WRIT

1

The question presented is of general and significant importance in determining the relative rights of an assignee of an account receivable or contract right as opposed to the rights of the United States government under a tax lien levied against the account receivable so assigned. This question is of particular importance since many states have adopted the provisions of the Uniform Commercial Code and the question arises whether failure to comply with the filing requirements of the code, which might give rights to "lien creditors" of the taxpayer, also gives rights to the United States under a tax lien even though the taxpayer, under state law, has parted with all "property" and "rights to property" in the account so assigned.

2

The decision entered by the United States Court of Appeals for the Eighth Circuit in this case conflicts with the opinion entered by the United States Court of Appeals for the Third Circuit on July 1, 1960, in the case of **In Re Halprin**, 280 Fed. 2d 407, and directly conflicts with the following decisions of United States District Courts:

Monroe Bank and Trust Company v. Allen, 286 F. Supp. 201 (Miss. 1968);

Union Life Insurance Company v. Perkins, 257 Fed. Supp. 154 (Ark.);

United States v. Lester, 235 Fed. Supp. 115 (New York, 1964).

3

The decision of the United States Court of Appeals for the Eighth Circuit is also in conflict with the basic ruling in **United States v. Bess**, 357 U.S. 51, 78 S. Ct.

1054, which states that Section 6321 of the Internal Revenue Act does not create property rights but merely attaches consequences, federally defined, to rights created under state law.

It is significant that in **United States v. Lester**, supra, the district court, in applying **Bess**, stated:

> "Moreover, that question is not determined by ascertaining what rights creditors of the taxpayer may have against the property under state law, as the Government seems to conceive here. In seeking to enforce its lien the Government is bound by the limitations of the statute. It can only reach property in which the taxpayer has an interest and its rights can rise no higher than his."

4

The decision of the United States Court of Appeals for the Eighth Circuit is in conflict with the decision of the Supreme Court of the State of Arkansas in the case of **Anderson v. First Jacksonville Bank**, 243 Ark. 977, 423 SW 2d 273, in which case the Arkansas Supreme Court held that a transaction such as the assignment involved in this case was good as between the parties without the necessity of filing as required by the Uniform Commercial Code.

5

The case of **In Re Halprin**, supra, decided by the Third Circuit, holds specifically that a contract account validly assigned by the taxpayer for the purpose of obtaining the necessary funds to perform the contract is not subject to the tax lien, even though in that case the tax lien was filed after the contract was entered into but prior to the performance thereunder and prior to the assignment

thereof. The district court cases also hold that after assignment of a contract right or account receivable, the assignor does not have property therein to which a federal tax lien can attach.

CONCLUSION

In view of the general importance and interest in the determination of this question and in view of the conflict of the decision in this case with other federal decisions, including **In Re Halprin**, supra, the petitioner feels that these questions should be decided by this Court so that the federal tax lien statute can be uniformly applied throughout the United States.

Wherefore, your petitioner prays that this Application for Writ of Certiorari be granted and for such further relief as this Court may determine proper.

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APPENDIX

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 71-1519
No. 71-1532

United States of America,
Appellant,

v.

T. C. Trigg, Ovid Switzer and Victor Scott,
Appellees and Cross-Appellants,

First State Bank, Crossett, Arkansas,
Appellee.

Appeal from the United States District Court for the Western District of Arkansas.

OPINION

Submitted: May 9, 1972.

Filed: August 17, 1972.

Before LAY, BRIGHT, and ROSS, Circuit Judges.

BRIGHT, Circuit Judge.

On this appeal, we consider three competing claims of priority to progress payments earned by a contractor per-

forming construction projects for two Arkansas municipalities. The United States claims priority to the funds under assessments and levies for the contractor's unpaid payroll taxes. A bank claims priority under an earlier unrecorded assignment of accounts receivable. Finally, three individuals, who agreed to indemnify the contractor's surety, claim priority as subrogees of mechanic's lienors and as successors in interest to the surety.

In an unreported opinion, the district court rejected the priority claims of the United States and awarded first priority to the bank, second priority to the indemnitors. The United States has appealed, and the indemnitors have cross-appealed; each claims first priority to the funds. For the reasons stated below, we reverse and award priority to the United States.

The parties have stipulated to the facts. On June 17, 1968, the Sutton Construction Co., Inc., entered into a contract to construct sanitary water and storm improvement facilities at McGehee, Arkansas. On August 14, 1968, the contractor entered into a similar contract with the City of Hope, Arkansas. The Maryland Casualty Company entered into performance-payment bonds, binding itself to both Arkansas municipalities as surety for the contractor under these construction contracts. In connection with the execution and issuance of the bonds, T. C. Trigg, Ovid Switzer, and Victor Scott, as individuals, entered into a "Blanket Indemnity Agreement" with Maryland Casualty Company, agreeing to indemnify Maryland Casualty for any liability which it might incur as surety for the contractor under the construction contracts.

To obtain financing for these projects, the contractor, on August 2, 1967, had executed an "Accounts Receivable Security Agreement" with the First State Bank, Crossett, Arkansas, assigning to the bank, as security for existing or future loans, all accounts receivable arising during the

term of the agreement. In late 1968, the contractor directed both Arkansas municipalities to make future payments due under the construction contracts payable jointly to the contractor and the bank. Relying on the security agreement and the written directions to the Arkansas municipalities, the bank advanced approximately $15,000 to the contractor to pay for labor and to purchase materials in performing the construction contracts. At the time the bank filed the complaint against the United States, the contractor remained indebted to the bank for $13,919.41. The bank failed to file the security agreement with the Arkansas Secretary of State or with the Clerk of the Circuit Court, the offices designated by the Arkansas Uniform Commercial Code. *See,* Ark. Stat. Ann. § 85-9-401(c) (1961).

For each taxable period between March 31, 1968 and March 31, 1969, the contractor failed to withhold income and to pay taxes due under the Federal Insurance Contribution Act. The amount assessed against the contractor by the government for taxes, interest, and penalties far exceeded the amount of the progress payments in question here. On March 3, 1969, the United States served a notice of levy upon McGehee, Arkansas, and received, on April 21, 1969, the sum of $10,763.59, the amount due the contractor for work performed between February 11, 1969, and March 1, 1969. On March 8, 1969, the United States served a notice of levy upon the City of Hope, Arkansas, and received, on March 20, 1969, the sum of $8,336.16, the amount due the contractor for work performed from February 1, 1969, to March 7, 1969.

On April 13, 1969, the contractor defaulted on its contracts with both Arkansas municipalities. The municipalities demanded that Maryland Casualty Company, as surety, complete performance of the contracts. Maryland Casualty, in turn, demanded that the indemnitors, Trigg,

Switzer, and Scott, hold Maryland harmless under the indemnity agreement. Pursuant to Maryland's demands, the indemnitors paid the contractor's previously unpaid material and labor claimants and secured a second contractor to complete the projects.

In awarding first priority to the bank, the district court determined that the contractor's assignment of accounts receivable to the bank divested the contractor of any property interest in the progress payments. Therefore, the court reasoned, the contractor held no property interest in the progress payments which the government could attach through a tax lien.

The judgment in favor of the bank did not exhaust the full amount of the progress payments plus interest.[1] Accordingly, the district court went on to determine the relative priorities of the United States and the indemnitors against the remainder. The court awarded second priority to the indemnitors, ruling that, by making payments to the materialmen and laborers who had filed mechanic's lien claims, the indemnitors succeeded to the priority rights granted the materialmen and laborers by Arkansas law. Because we hold that the United States is entitled to the total amount of the progress payments, we need not determine the relative priorities between the bank and the indemnitors.

BANK v. UNITED STATES

We consider first the claim of the bank against the United States. The Federal Tax Lien Law provides:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, additional

---

[1] From a fund of $21,657.54, representing the progress payments plus interest, the district court awarded $17,328.87 to the bank and $4,328.67 to the indemnitors.

> to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. [26 U.S.C. §6321]

On this appeal, the bank leans heavily upon a series of Supreme Court cases holding that the Federal Tax Lien Statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law * * *." *United States v. Bess,* 357 U.S. 51, 55 (1958); see *United States v. Durham Lumber Co.,* 363 U.S. 522, 526 (1960); *Aquilino v. United States,* 363 U.S. 509, 513 (1960). In *Aquilino* the Court said:

> The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had "property" or "rights to property" to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute. [363 U.S. at 512-13]

The bank argues that, under Arkansas law, the contractor's assignment of accounts receivable to the bank effected a transfer to the bank of the property rights in the accounts receivable, leaving the contractor with no property interest which the United States could reach under the statute.

We do not agree that, under Arkansas law, the assignment of accounts receivable placed the progress payments beyond the reach of a tax lien. Arkansas adopted the Uniform Commercial Code (UCC) in 1961. Ark. Stat. Ann.

§§85-1-101 et seq. (1961). The UCC requires holders of certain security interests in property to record their interest in order to protect it from the claims of third parties. Assignees of accounts receivable fall under this filing requirement. Ark. Stat. Ann. §85-9-302 (1961).[2] In Arkansas, assignees of accounts receivable must file their interest both centrally with the Secretary of State and locally with the Clerk of the Circuit Court. Ark. Stat. Ann. §85-9-401(c) (1961).

Unless the security interest is perfected by filing, third party creditors may gain rights against the collateral. See Ark. Stat. Ann. §85-9-301. The UCC subordinates the right of a holder of an unperfected security interest to the right of a "person who becomes a lien creditor without knowledge of the security interest * * *." Ark. Stat. Ann. §85-9-301(1)(b). The term "lien creditor" is defined as follows:

> A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like * * *. [Ark. Stat. Ann. §85-9-301(3)]

The United States qualifies as a "lien creditor" under this definition of the term. *See L. B. Smith, Inc. v. Foley,* 341 F. Supp. 810, 813-14 (W.D.N.Y. 1972).

The UCC does not classify the debtor's interest in the collateral securing the debt as "property" or "rights to property," the terms traditionally used by the Supreme Court. *See Aquilino v. United States, supra,* 363 U.S. at 514. The draftsmen made no attempt to fix location of title to collateral securing a creditor's interest. Ark. Stat. Ann. § 85-9-202 provides:

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[2] Ark. Stat. Ann. § 85-9-302(e) (1961) excepts from the filing requirement certain isolated assignments of accounts receivable. The bank has not argued that the assignment in this case falls within the exceptions created by that section.

> Each provision of [Article 9] with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

The comment to this section explains:

> The rights and duties of the parties to a security transaction *and of third parties* are stated in this Article without reference to the location of "title" to the collateral. (emphasis added.)

The UCC focuses on rights and duties of the secured party, the debtor, and third parties, rather than on the location of title. As a result, the draftsmen found it unnecessary to classify the legal interest held by the secured party and by the debtor in the collateral. If the secured party fails to perfect his interest, the UCC grants rights against the collateral to third party creditors regardless of the legal interest held by either the secured party or the debtor. Ark. Stat. Ann. § 85-9-301 (1961).

In this case, because the bank failed to file its security interest, it held only an unperfected interest in the contractor's accounts receivable. To be sure, the UCC provides some protection to holders of unperfected interests by making such interests enforceable between the parties. Ark. Stat. Ann. § 85-9-201. At the same time, however, the UCC makes unperfected interests vulnerable to the claims of third parties. We hold that the contractor's assignment of accounts receivable to the bank did not place the progress payments beyond the reach of the federal tax lien. The UCC plainly provides that a lien creditor, such as the United States, may reach property securing an unperfected interest in accounts receivable:

> [A]n unperfected security interest is subordinate to the rights of * * * a person who becomes a lien creditor without knowledge of the security interest and before it is perfected. [Ark. Stat. Ann. § 85-9-301(1)(b)]

Our determination that the United States may reach the progress payments under the Federal Tax Lien Statute answers only the threshold question posed by *Aquilino*: Whether the taxpayer held an interest in property to which the federal tax lien could attach. We now must determine the priority of the competing claims. For that determination, we are bound to apply federal law. *See, e.g., United States v. Equitable Life Assurance Society of the United States*, 384 U.S. 323, 327 (1966); *Aquilino v. United States, supra*, 363 U.S. at 513-14; *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 49 (1950); *United States v. First Nat'l Bank & Trust Co. of Fargo, N. D.*, 386 F.2d 646, 647 (8th Cir. 1967).

Under the basic federal priority standard, "first in time is first in right," a federal tax lien takes priority over a state-created lien unless the state lien is specific and perfected in the federal sense before the federal tax lien arises. *United States v. Equitable Life Assurance Society of the United States, supra*, 384 U.S. at 327. With certain statutory exceptions, *see* 26 U.S.C. § 6323(a), a federal tax lien arises on the date of assessment. 26 U.S.C. § 6322; *see United States v. Vermont*, 377 U.S. 351, 353 n.3 (1964). At the time the United States assessed the contractor's tax liability, the bank's security interest was not specific and perfected, in the federal sense, because filing was required to protect the security interest against third party creditors. *See United States v. Crest Finance Co.*, 302 F.2d 568, 569 (7th Cir. 1962), *on remand from* 368 U.S. 347 (1961); *cf. United States v. New Britain*, 347 U.S. 81, 84 (1954).

The 1966 amendments to the Federal Tax Lien Statute expanded the classes of claims which are entitled to priority over federal tax liens. *See* S.Rep. No. 1708, 89th Cong., 2d Sess. (1966), in 3 *U. S. Code Congressional and Administrative News* 3722 (1966). Holders of security

interests are among those creditors who were granted added protection. Under 26 U.S.C. § 6323(a),[3] a federal tax lien is not valid against the holder of a security interest until the tax lien is filed. Under 26 U.S.C. § 6323 (c)(1),[4] certain security interests in specified property take priority over a federal tax lien even if the security interest comes into existence after the federal tax lien is filed. Significantly, however, Congress extended the added protection only to holders of perfected security interests by defining a security interest as follows:

> The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and

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[3] 26 U.S.C. § 6323(a) provides:

The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

[4] 26 U.S.C. § 6323(c)(1) provides:
To the extent provided in this subsection, even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which—

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting—

(i) a commercial transactions financing agreement,

(ii) a real property construction or improvement financing agreement, or

(iii) an obligatory disbursement agreement, and

(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

> (B) to the extent that, at such time, the holder has parted with money or money's worth. [26 U.S.C. § 6323(h)(1)]

See 26 U.S.C. § 6323(c)(1)(B). As a result, holders of unperfected interests remain subject to the "first in time is first in right," priority standard. Under that standard, unperfected security interests are subordinate to a federal tax lien.

Accordingly, we think it is clear in this case that the federal tax lien takes priority over the bank's security interest. If the bank had properly filed its security interest, the result would have been different under the present Federal Tax Lien Statute.[5]

INDEMNITORS v. UNITED STATES

We now turn to the claim of the indemnitors against the United States. The indemnitors advance two alternative arguments in support of their priority claim. We reject each argument.

A.

The indemnitors first argue that, at the time of the tax levies, the contractor possessed no property rights in the progress payments. They contend that, under equitable principles, the contractor's indebtedness to materialmen and laborers caused the property interest to pass to the materialmen and laborers and then successively to the surety and to the indemnitors through subrogation.

---

[5] The United States filed notices of the tax liens with the Circuit Clerk, Ashley County, Arkansas, on January 15, 1969, and February 12, 1969. The bank claims priority against the progress payments for loans made to the contractor on February 21, 1969, and February 28, 1969. Although, as to these loans, the bank's security interest did not arise until after the tax liens were filed, the bank would take priority under the forty-five day rule of 26 U.S.C. § 6323(c)(2)(A) if it had perfected its security interest.

We have not found any Arkansas authority which supports the position that the contractor's property interest in the progress payments passed to the materialmen and laborers simply because of the contractor's indebtedness to those parties.

The indemnitors advance a collateral argument that they succeeded to the rights of materialmen and laborers who filed mechanics liens and are therefore entitled to priority for the amount of these liens. We find this argument untenable. In Arkansas, public projects are not subect to mechanics' and materialmen's liens. *See National Surety Corp. v. Edison*, 401 S.W.2d 754, 756 (Ark. 1966) (Smith, J., concurring). To protect mechanics and materialmen, Arkansas requires contractors to furnish a bond on public construction contracts exceeding $3,000. *See* Ark. Stat. Ann. §51-632 (1971). At the same time, Arkansas limits the claims of mechanics and materialmen to the surety bond. *See* Ark. Stat. Ann. §51-636 (1971); *Stewart-McGehee Construction Co. v. Brewster*, 284 S.W. 53, 54 (Ark. 1926). Thus, Arkansas does not grant to materialmen and mechanics rights against either the public project or funds in the hands of the contractor. Accordingly, the indemnitors acquired no derivative right to the progress payments through the materialmen and laborers.

B.

Secondly, the indemnitors argue that they are entitled to priority because the Federal Tax Lien Statute grants a "super priority" over a previously filed tax lien to certain classes of creditors. *See* 26 U.S.C. §§6323(b) and (c). Creditors who are acquired to make payments under an obligatory disbursement agreement are accorded a "super priority" under 26 U.S.C. §6323(c)(1)(A)(iii). That section provides:

> To the extent provided in this subsection, even though notice of a lien imposed by §6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence *after* tax lien filing but which * * * is in qualified property covered by the terms of a written agreement entered into *before* tax lien filing and constituting * * * an obligatory disbursement agreement * * *. (emphasis added)

An obligatory disbursement agreement is defined as follows:

> The term "obligatory disbursement agreement" means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made by reason of the intervention of the rights of a person other than the taxpayer. [26 U.S.C. §6323(c)(4)(A)]

The Senate Committee Report explained the priority for obligatory disbursement agreements.

> Obligatory disbursement agreement.—The third category of interest given priority over a filed tax lien is that arising from an obligatory disbursement agreement. This is an agreement entered into by a person under which he is obliged to make disbursements because someone other than the taxpayer has relied on his obligation. An example is an irrevocable letter of credit where a bank issuing the letter must honor a demand for payment by a third party who advances credit in reliance upon the letter. This also covers cases where a surety agrees to finance the completion of a contract entered into by the taxpayer. In these cases no limitation is placed on the time during which a disbursement may be made as long as the person is obligated to do so at the time of the tax lien filing

by a written agreement. As a result, if an effort is made to foreclose on a Federal tax lien before all of the potential obligations under an obligatory disbursement contract are met, these potential obligatory disbursements are given priority over the Federal tax lien. In such a case an amount sufficient to cover the potential obligations usually is set aside and used for these obligations. Only after these obligations have been met is any remainder available to satisfy the liability secured by the Federal tax lien.

Your committee's bill gives priority to interests arising under obligatory disbursement agreements as against filed tax liens since the obligation arises before the filing of the tax lien, although the disbursements are made after that time. [S.Rep. No. 1708, 89th Cong., 2d Sess. (1966), in 3 U.S. Code Congressional and Administrative News 3730 (1966)]

Based on the language of the statute and the Senate Committee's comments, we think that the surety, Maryland Casualty Company, would clearly be entitled to priority against the progress payments if it had actually made disbursements under the suretyship agreement. We do not believe, however, that the indemnitors are entitled to the same priority. The statute contains an important limitation on the type of creditor entitled to the superpriority. Only creditors who enter into obligatory disbursement agreements "in the course of [their] trade or business" are entitled to the priority. 26 U.S.C. §6323 (c)(4)(A). The Senate Committee Report specifically notes:

Interests arising under these agreements are given priority over a filed tax lien only if the agreements are entered into by the disburser in the ordinary course of his trade or business. [S.Rep. No. 1708, 89th Cong., 2d Sess. (1966), in 3 U.S. Code Congressional and Administrative News 3730 (1966)]

In this case, the indemnitors failed to show that they assumed the obligation to indemnify the surety as an incident to their trade or business. The record shows only that Trigg was engaged in the "investment business," Scott in the real estate business, and Switzer in the practice of law. On this record, we cannot say that the indemnitors are entitled to priority under 26 U.S.C. §6323 (c)(1)(A)(iii).

In a brief submitted following oral argument, the indemnitors argue that they "acted as an extension of the surety" and consequently, "stand in the shoes of the surety." In this case, however, the surety acquired no priority rights to which the indemnitors could succeed. The provisions of the lien statute relating to obligatory disbursement agreements create a priority

> [o]nly to the extent of disbursements which are required to be made by reason of the intervention of the rights of a person other than the taxpayer. [26 U.S.C. §6323(c)(4)(A)]

In this case, since the surety, Maryland Casualty Company, made no disbursements to materialmen and laborers, the surety did not acquire a priority over the federal tax lien. Thus, although the Federal Tax Lien Statute explicitly recognizes rights of subrogation, *see* 26 U.S.C. §6323(i)(2), the indemnitors could not acquire a priority right which the surety did not hold.

CONCLUSION

We remand this case to the district court and direct that the claims of the bank and the indemnitors be dismissed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit

In the United States District Court
Western District of Arkansas
El Dorado Division

T. C. Trigg, Ovid Switzer, Victor Scott and First State Bank, Crossett, Arkansas, Plaintiffs, v. United States of America, Defendant.	No. Ed 69-C-43

MEMORANDUM OPINION

(Filed June 23, 1971)

The plaintiffs, T. C. Trigg, Ovid Switzer, Victor Scott and First State Bank, Crossett, Arkansas, bring this action against the United States to recover sums of monies for alleged wrongful levies upon the proceeds due under construction contracts between Sutton Construction Company, Inc., and the City of Hope, Arkansas, and the Sewer Improvement District No. 2, McGehee, Arkansas. The plaintiffs seek to recover the sum of $8,336.16 allegedly due Sutton Construction Company, Inc., as installment payments under a contract with the City of Hope, Arkansas, which monies were turned over to the Internal Revenue Service of the United States of America by the City of Hope, Arkansas, on demand March 20, 1969. The plaintiffs also seek to recover $10,763.59 allegedly due the Sutton Construction Company, Inc., as installment payments under contract with the Sewer Improvement District No. 2, McGehee, Arkansas, which monies were turned over to the Internal Revenue Service of the United States of America by the Sewer Improvement District No. 2, McGehee, Arkansas, on demand April 21, 1969.

This action is brought pursuant to the provisions of Section 7426 of the Internal Revenue Code (26 U.S.C.A. § 7426). This litigious proceeding is submitted to the Court on stipulation of the parties, the pleadings, responses to interrogatories, answers to request for admission of facts and exhibits.

The undisputed facts in the case establish that on August 14, 1968, the Sutton Construction Company, Inc., entered into a contract with the City of Hope, Arkansas, for the construction of a sanitary water and storm sewer improvement for a total consideration of $112,435.16. On June 17, 1968, the Sutton Construction Company, Inc., entered into a contract with the Sewer Improvement District No. 2, McGehee, Arkansas, for the construction of a sanitary water and storm sewer improvement for a total consideration of $164,418.76.

It is further established that Maryland Casualty Company entered into performance and payment bonds binding itself to both the City of Hope, Arkansas, and the Sewer Improvement District No. 2, McGehee, Arkansas, as surety for Sutton Construction Company, Inc., under contracts of August 14, 1968, and June 17, 1968.

It is also undisputed that on May 9, 1968, the plaintiffs, T. C. Trigg, Ovid Switzer and Victor Scott entered into a blanket indemnity agreement with Maryland Casualty Company agreeing to indemnify Maryland Casualty Company for any and all liabilities which Maryland Casualty Company might incur as surety for Sutton Construction Company, Inc., including any liabilities incurred under the contract of August 14, 1968, and June 17, 1968.

On August 2, 1967, Sutton Construction Company, Inc., by its president, Jimmy F. Sutton, executed an accounts receivable security agreement granting to the plaintiff, First State Bank of Crossett, Arkansas, a security interest

in all of Sutton Construction Company's existing accounts receivable and the Company's accounts receivable which thereafter came into existence during the term of the security agreement and in the proceeds of the existing and future accounts receivable. The security agreement, therefore, contained an assignment of all accounts receivable of Sutton Construction Company, Inc.

On November 1, 1968, Sutton Construction Company, Inc., by its president, Jimmy F. Sutton, directed in writing to Sewer Improvement District No. 2, McGehee, Arkansas, to make all payments to become due Sutton Construction Company, Inc., under the contract of June 17, 1968, jointly to Sutton Construction Company, Inc., and First State Bank, Crossett, Arkansas. On December 31, 1968, a similar direction in writing was given the City of Hope, Arkansas, with regard to payments to be made under its contract of August 14, 1968.

Relying on the security agreement of August 2, 1967, together with the written directions given the City of Hope, Arkansas, on December 31, 1968, and the Sewer Improvement District No. 2, McGehee, Arkansas, on November 1, 1968, the plaintiff, First State Bank, Crossett, Arkansas, advanced more than $16,934.01, which was used specifically to pay labor and to purchase materials under the contracts of August 14, 1968, and June 17, 1968. Sutton Construction Company, Inc., is indebted to First State Bank in the total sum of $15,282.64 by virtue of advances made on February 21, 1969, in the sum of $11,282.62 and on March 3, 1969, in the sum of $4,000.

On the dates and for the taxable periods stated, the District Director of the Internal Revenue Service made assessments against Sutton Construction Company, Inc., for unpaid withheld income and Federal Insurance Contributions Act, taxes in the amounts, as follows:

Taxable Period Ending	Date of Assessment	Amount of Assessment
3-31-68	6-21-68	$ 5,106.71-T 44.00-I
6-30-68	9-13-68	4,500.06-T
9-30-68	12-30-68	12,067.72-T 93.19-I
12-31-68	2- 7-69	10,282.77-T 171.98-P-I 11.83-I
3-31-69	5-19-69	9,875.99-T 493.80-P-I 164.60-P-2 30.85-I

T—denotes tax; P-I—denotes penalty assessed under Section 6651, Internal Revenue Code, 1954; P-2—denotes penalty assessed under Section 6656, Internal Revenue Code, 1954; I—denotes interest.

On March 7, 1969, the District Director made assessments against Sutton Construction Company for Federal Unemployment Tax Act taxes for the taxable period ending December 31, 1968, of $559.28, together with interest in the amount of $3.16.

Contemporaneously with the making of the assessments by the District Director on June 21, 1968, September 13, 1968, December 30, 1968, February 7, 1969, and May 19, 1969, notice of the making of the assessments was given to and demand for payment was made upon Sutton Construction Company, Inc. Sutton has not paid the assessments as demanded and they remain unpaid.

Notice of Federal Tax Liens were filed on January 15, 1969, and on February 12, 1969, with the Circuit Clerk for Ashley County, Arkansas, for the assessments of December 20, 1968, and February 7, 1969, respectively.

On March 3, 1969, the United States served notice of levy upon the Sewer Improvement District No. 2, McGehee, Arkansas, and received on April 21, 1969, the sum

of $10,763.59 due under the contract of August 14, 1968, as an estimated payment for work performed between February 11, 1969, and March 1, 1969. On March 8, 1969, the United States served notice of levy upon the City of Hope, Arkansas, and received on March 20, 1969, the sum of $8,336.16 due under the contract of June 17, 1968, as an estimated payment for work performed from February 1, 1969, and ending March 7, 1969.

On April 13, 1969, Sutton Construction Company, Inc., defaulted under the contracts of August 14, 1968, and June 17, 1968.

The City of Hope, Arkansas, and Sewer Improvement District No. 2, McGehee, Arkansas, made demand upon Maryland Casualty Company to complete the contracts of August 14, 1968, and June 17, 1968. Maryland Casualty Company subsequently made demand upon the plaintiffs, T. C. Trigg, Ovid Switzer and Victor Scott, to hold it harmless under the blanket indemnity agreement of May 9, 1968. Pursuant to Maryland's demand, Trigg, Switzer and Scott completed the contracts and made payment of unpaid bills for labor and materials furnished Sutton Construction Company, Inc., due under its contracts.

The United States claims these sums by reason of its tax liens; the First State Bank, Crossett, Arkansas, makes its claim by virtue of the assignment of the funds; and Trigg, Switzer and Scott make their claim by subrogation, claiming that they are subrogated to the rights of various lien claimants.

The threshold question for determination by the court is whether Sutton Construction Company, Inc., had a property right in the proceeds of the contracts subsequent to the assignment contained in the security agreement of August 2, 1967, to the First State Bank. It is established that the assignment made under the security agreement was valid and binding between Sutton and the Bank, and,

therefore, Sutton retained no right or authority to collect any of the proceeds of the contracts until the First State Bank was fully paid.

The validity of the security agreement between Sutton Construction Company, Inc., and First State Bank is determined by Arkansas law. This question was clearly stated in *United States v. Lester,* 235 F.Supp. 115, 119-20 (1964), as follows:

> "Whether or not the taxpayer has any interest in property on which levy is sought to be made, however, is determined by state rather than federal law. Aquilino v. United States, 363 U.S. 509, 80 S.Ct. 1277, 4 L.Ed.2d 1365 (1960); United States v. Durham Lumber Co., 363 U.S. 522, 80 S.Ct. 1282, 4 L.Ed.2d 1371 (1960); United States v. Bess, 357 U.S. 51, 78 S.Ct. 1054, 2 L.Ed.2d 1135 (1958); Fidelity & Deposit Co. of Maryland v. New York City Housing Authority, 241 F.2d 142 (2 Cir. 1957)."[1]

By enacting the Uniform Commercial Code the General Assembly of Arkansas provided in Ark. Stats. Ann. 85-9-102 that the Code is applicable to:

> "(b) to any sale of accounts, contract rights or chattel paper."

In Section 85-9-204 of the Code, with reference to secured transactions, the Legislature provided that security interest attaches when there is an agreement as provided by the Code, that it attach and value is given and the debtor has rights to the collateral. It attaches as soon as all of the events required have taken place. In Subsection (3) it is provided:

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[1] In Arkansas secured transactions are provided by the Uniform Commercial Code. Ark. Stats. Ann. 85-9-101–85-9-507 (1961 Addendum).

"(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement."

And further:

"(5) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment."

The Arkansas Supreme Court has affirmed the validity of security transactions under the Uniform Commercial Code by stating as follows:

"This being a suit between the parties, Ark. Stat. Ann. §§ 85-9-201 to 85-9-204 (Add: 1961) control. Section 85-9-201 reads: 'Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties * * *.' See also Ward Industries Corp. v. Bizzy Bee Cleaners, Inc., 6 Adams County Legal Journal 191 (Pa. 1965). Section 85-9-203 provides that the only requirements for an enforcible security interest against a debtor are: (a) a written agreement; (b) the debtor's signature; and (c) a description of the collateral. In the case before us all the requirements are met. So according to Section 85-9-204, the security interest here attaches immediately because no explicit agreement postponed the time of attaching." *Anderson v. First Jacksonville Bank,* 243 Ark. 977, 423 S.W.2d 273.

The Supreme Court of Arkansas again construed the provisions of the Uniform Commercial Code in *General Electric Credit Corp. v. Bankers Commercial Corp.,* 244 Ark. 984, 429 S.W.2d 60:

"Where assignee of contract for sale held a valid security agreement, as between it and debtor, the

assignee had an enforceable cause of action notwithstanding assignee's failure to file any notice of its creditorship which might have allowed later valid claims to take priority."

On the record in the instant case it is stipulated that the assignment from the taxpayer, Sutton, to the plaintiff, First State Bank, was made prior to the time when the Government's tax lien became effective. On its face the assignment was absolute and divested Sutton of any rights whatsoever as it passed his interest in the accounts receivable to First State Bank. The assignment was made in Arkansas and both parties lived in Arkansas.

If the assignment of Sutton to First State Bank had the effect of divesting Sutton of all of its interest under applicable state law, the Government's claim cannot stand.

> "It is of course elementary that the Government may not take one person's property to satisfy another's tax obligations. Unless it is established that the taxpayer is the owner of or has some interest in the property on which levy is sought to be made, the Government cannot enforce its lien against such property and the statutes relating to the lien and its enforcement so provide. In such case there is nothing to which the lien can attach." *United States v. Lester*, supra, at page 119.

It is further provided in *Lester*, at page 119:

> "Moreover that question is not determined by ascertaining what rights creditors of the taxpayer may have against the property under state law, as the Government seems to conceive here. In seeking to enforce its lien the Government is bound by the limitations of the statute. It can only reach property in which the taxpayer has an interest and its rights can rise no higher than his. City of New York v.

United States, 283 F.2d 829 (2 Cir. 1960); Central Surety & Insurance Corp. v. Martin Infante Co., 272 F.2d 231 (3 Cir. 1959); United States v. Burgo, 175 F.2d 196 (3 Cir. 1949); Transmix Concrete of Rockdale v. United States, 142 F.Supp. 306 (W.D. Tex. 1956)."

Since it is established that the assignment of the accounts receivable contained in the August 2, 1967, security agreement to the First State Bank by Sutton Construction Company, Inc., was valid and binding and for which the First State Bank advanced substantial sums of money, Sutton had no right in the proceeds of its contracts. This rule is succinctly stated in *6 Am. Jur. 2d § 105 Assignments*, Page 288:

"Obviously, one who has made a valid assignment of a claim has no right thereafter, unless authorized by the assignee, to receive payment from the debtor."

The Government contends that it is entitled to the funds on a priority basis as the plaintiff, First State Bank, failed to perfect its security agreement assignment from Sutton by filing it with the Circuit Clerk of Ashley County, Arkansas. The Government argues that under the provisions of Ark. Stats. Ann. 85-9-301(1)(b) (1961 Addendum) an unperfected security interest is subordinate to the rights of a judgment lien creditor who acquires such status prior to perfection of the security interest. The Court cannot agree with this contention of the Government. It is established under Arkansas law that the absence of recordation of the interest has no bearing on the validity of the assignment as between the parties.

In *Union Life Insurance Company v. Perkins*, 257 F. Supp. 154, Henley, C.J., stated:

"The Government's attack on the validity of the June 11, 1962, authorization from Perkins to Union

as an assignment of 25 percent of the earned commissions cannot be sustained.

"It is true that the authorization was not recorded as provided by the relevant provisions of the Arkansas version of the Uniform Commercial Code, Ark. Stats. Anno., Sec. 85-9-301 et seq. But the absence of recordation, although it might well affect priorities would have no bearing on the validity of the instrument as between the immediate parties thereto." See e.g. *United States v. Thompson*, 272 F.Supp. 774, 782 (1967).

In *Anderson v. First Jacksonville Bank*, supra, the Arkansas Supreme Court, at page 274, in construing the section of the Uniform Commercial Code relied upon here by the Government, stated:

"Sections 85-9-301 to 85-9-304 are not here applicable. Those sections concern priorities of perfected and unperfected security interests as against third persons."

Consequently, since Sutton had assigned his interest of the collateral, accounts receivable, to the First State Bank and, therefore, retained no interest in the collateral, there is no lien available under the Code which attach pursuant to the provisions of priorities.

This identical question was considered and determined in *Monroe Banking & Trust Company v. Allen*, 286 F. Supp. 201 (N.D. Miss. E.D. 1968). In that case Building Service Company became the general contractor. It subcontracted to Allen the painting and caulking on the Raspet Flight Laboratory job, which was evidenced by written agreement between them. Allen applied to the Monroe Banking & Trust Company for funds to finance labor and materials needed for the job. The Bank agreed to provide the funds on the condition that the proceeds

of the subcontracts be assigned to the Bank as security for the loan. He executed a letter, as in the instant case, authorizing the general contractor, Building Service Company, to "make all checks due me on the Raspet Flight Laboratory . . . payable both to myself and to Monroe Banking & Trust Company." Relying on the security agreement the Bank made various loans to Allen pursuant to the assignment.

The Government there, as here, based its claim on Sections 6321-6323, inclusive, of the Internal Revenue Code of 1954. The Government claimed that the Bank assignments due to their precise nature were not effective, thus leaving to Allen property rights in the proceeds of the contracts to which the tax liens attached. Further, the Government claimed that although the bank may have gained some interest in the proceeds, it still did not qualify as a mortgagee, pledgee or purchaser, under § 6323(a) so as to be protected prior to the filing of the lien notices in Monroe County, Mississippi, nor as the pledgee of a "security", under § 6323(c)(1), until it had actual knowledge of the tax lien. There the Mississippi law was applicable. It was established that there was ample authority among Mississippi decisions to establish that the financial arrangements disclosed by the record constituted equitable assignments which were effective and binding upon all parties.

The court stated at page 212, as follows:

> "The substantive acts of the parties indicate that they all intended that Allen would be deprived of any interest in the proceeds until the Bank had been paid in full. It is clear that the Bank proposed and carried out its agreement to lend up to 65% of the value of the subcontracts; * * * and the Bank did not proceed to make any loans until Allen had executed the letters of authority and had same accepted

by Building Service. All of these arrangements were understandingly and purposely made by the interested parties, showing an intention consistent with vesting in the Bank an ownership of the subcontracts' proceeds to the extent of its advances." This is precisely the situation in this case between Sutton and First State Bank.

The court stated in *Monroe*, supra, at page 212:

"In Mississippi, the assignee of a non-negotiable chose in action is invested with an equitable title by delivery alone, which the courts of law will protect. Simmons v. Smith County Bank, 225 Miss. 384, 83 So.2d 441 (1955); Anaconda Aluminum Company v. Sharp, 243 Miss. 384, 83 So.2d 585, 99 A.L.R.2d 1307 (Miss. 1962). These cases align Mississippi with the general rule that 'the true test of an equitable assignment is whether the debtor would be justified in paying the debt to the person claiming to be the assignee'. 6 Am.Jur.2d, Assignments, § 83, p. 266. Under state law there was a valid, equitable assignment of the proceeds of each of the three subcontracts. The circumstances surrounding the transaction and the legal effect thereof are undisputed by the assignor, assignee and the obligor, and questioned only by a stranger to the transaction. At no time subsequent to the effective date of any of the three assignments could Jack Allen have had any property rights in a legal sense in such proceeds until the Bank was first satisfied. Moreover, from an economic standpoint these subcontracts, without bank financing, represented nothing of present value to Allen, and it was the Bank's advances which enabled any funds whatsoever to be realized upon the subcontracts. The position of the government is without any appeal, particularly because all three subcontracts had been made, the pro-

ceeds assigned to the Bank, and the Bank had made all its advances on the first two jobs and substantial advances on the last job, before the assessment against Allen of the oldest tax liability, an event which did not occur until December 14, 1962."

The court there, concluded:

"There being no property or rights to property remaining in Allen subsequent to the dates of the respective assignments, the government's claim must fail. There is thus no need to enter the province of federal law, since an interpretation of § 6323(a) and (c)(1) is to be resorted to only after there is an initial determination that the tax payer had 'property rights' to which a tax lien might attach. Morgan v. Commissioner of Internal Revenue, 309 U.S. 78, 626, 60 S.Ct. 424, 84 L.Ed 585, 1035 (1940); United States v. Colotta, 350 U.S. 808, 76 S.Ct. 82, 100 L.Ed. 725 (1955); United States v. Bess, 357 U.S. 51, 78 S.Ct. 1054, 2 L.Ed.2d 1135 (1958)."

As in that case, the plaintiff, First State Bank, here relying on the assignments by Sutton Construction Company, Inc., advanced monies which enabled Sutton to perform the contracts, and these advances paid for labor and material which went into the jobs and created the sums which were paid over to the Government on its tax liens.

Section 6321 of the Internal Revenue Code of 1954 (26 U.S.C.A. § 6321), which is basic in this proceeding, provides that one's failure to pay any tax will result in a lien upon "all property and rights to property * * * belonging to such persons". Sutton having assigned its rights to the proceeds of the two contracts (accounts receivable) to First State Bank, had no property rights to which the Government's lien would attach. The Court concludes

that the plaintiff, First State Bank, is entitled to the proceeds and should have a judgment accordingly.

Having disposed of the question between the First State Bank, Crossett, Arkansas, and the defendant, United States of America, the Court turns to the issue as to the rights between the plaintiffs, First State Bank and T. C. Trigg, Ovid Switzer and Victor Scott, as indemnitors of Sutton. As indemnitors, Trigg, Switzer and Scott had no claim until the default of Sutton Construction Company in April, 1969. All sums involved in this case had become due before that time. The indemnitors stand in no better position than Sutton. Consequently, the prior assignment by Sutton to the Bank would take priority over any claim which they might have by way of subrogation or otherwise.

The next and final question for the Court is to determine the rights and interest between the plaintiffs, T.C. Trigg, Ovid Switzer and Victor Scott, as indemnitors of Sutton, and the United States of America, as to the remainder of funds being held by the Government. The Court has already concluded that the First State Bank is entitled to the sum of $15,282.64 of the total sum of $19,099.75, which the Government demanded and collected from the City of Hope, Arkansas, and the Sewer Improvement District No. 2, McGehee, Arkansas. There remains the sum of $3,817.11 at issue between the indemnitors and the Government.

It is stipulated that as indemnitors of the surety, Maryland Casualty Company, Trigg, Switzer and Scott completed the contracts of Sutton and made payment of unpaid bills for labor and materials furnished to Sutton and due under its contracts. It is further established that the indemnitors paid for labor and materials furnished Sutton and due under the contracts substantially greater than the amount remaining in issue here.

As indemnitors to the surety, Maryland, Trigg, Switzer and Scott became subrogated to any rights of laborers and materialmen for such sums as they paid for labor and materials furnished under Sutton's contracts with the City of Hope, Arkansas, and the Sewer Improvement District No. 2, McGehee, Arkansas. *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132. Therefore, the indemnitors by subrogation are entitled to only such rights and interest held by those who performed the labor and supplied materials under the Sutton contracts.

The rights and interest of laborers and materialmen providing the labor and furnishing materials to the extent of their unpaid claims are determined under state law. In this case the rights and interest of those who performed the labor and supplied the materials are determined under Arkansas Lien Law, *Ark. Stats. Ann. 1947, §§ 51-602—51-615; Aquilino v. United States,* 363 U.S. 509.

Ark. Stats. Ann. 1947 § *51-601* provides: That those who perform any work or furnish any material for improvements under and by virtue of a contract with the owner or proprietor, or his agent, trustee, contractor or subcontractor, shall have a lien upon such improvement.[2]

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2 "51-601. Lien upon building, land or boat—Persons entitled to—Penalty for failure to discharge liens upon payment.—Every mechanic, builder, artisan, workman, laborer or other person who shall do or perform any work to or upon, or furnish any material, fixtures, engine, boiler or machinery for any building, erection, improvement to or upon land, or upon any boat or vessel of any kind, or for repairing same, under or by virtue of any contract with the owner or proprietor thereof, or his agent, trustee, contractor or subcontractors, upon complying with the provisions of this Act [§§ 51-601, 51-604–51-626] shall have for his work or labor done, or materials, fixtures, engine, boiler or machinery furnished a lien upon such building, erection or improvement, and upon the land belonging to such owner or proprietor on which the same are situated, to the extent of one [1] acre, or to the extent of any number of acres of land upon which work has been done or improvements erected; or if such building, erection or improvement be upon any lot of land in any town, city or village then such lien shall be upon such building, erection or improve-

***Ark. Stats. Ann. 1947* § *51-613* provides: That for a person to avail himself of the lien laws of Arkansas, he has the duty of filing with the Circuit Court of the County in which the labor was performed or the material furnished for such improvement to be charged with the lien within 120 days after performing the labor and furnishing the material. It further requires a just and due account of the demand due and owing after allowance of all credits.[3]**

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ments, and the lots or land upon which the same are situated; or if such erection or improvement be upon any boat or vessel, then upon such boat or vessel, to secure the payment of such work or labor done, or materials, fixtures, engine, boiler or machinery furnished as aforesaid. Any original or principal contractor or his assignee who shall be paid the contract price or any portion thereof, and who shall fail or refuse to discharge the liens created by this section, to the extent of the contract price received by him, shall be deemed guilty of an offense and punishable as follows:

"If the amount of the contract price which he receives and fails to apply toward the discharge of the liens created by this section exceeds the sum of Ten Dollars ($10.00), the party shall be deemed guilty of a felony and shall be punished by imprisonment in the penitentiary not less than one (1) nor more than five (5) years. If the amount does not exceed the sum of Ten Dollars ($10.00), the party shall be deemed guilty of a misdemeanor and punished by imprisonment in the county jail not more than one (1) year and shall be fined in any sum not less than Ten Dollars ($10.00) nor more than Three Hundred Dollars ($300.00). [Act Apr. 20, 1895, No. 146, § 1, p. 217; C.&M. Dig., § 6906; Acts 1923, No. 563, § 1, p. 458; Pope's Dig., § 8865; Acts 1969, No. 112, § 1, p.....]"

[3] "51-613. Account filed with circuit court clerk—Contents.—It shall be the duty of every person who wishes to avail himself of this act [§§ 51-601, 51-604–51-6261] to file with the clerk of the circuit court of the county in which the building, erection or other improvement to be charged with the lien is situated, and within one hundred and twenty (120) days after the things aforesaid have been furnished or the work or labor done or performed, a just and true account of the demand due or owing to him, after allowing all credits, and containing a correct description of the property to be charged with said lien, verified by affidavit. [Act Apr. 20, 1895, No. 146, § 1, p. 217; C.&M. Dig., § 6922; Pope's Dig., § 8881; Acts 1961, No. 239, § 1, p. 843.]"

It is established under Arkansas law that the lien is valid if filed within 120 days after the last purchase or the last labor performed. *Hill v. Imboden*, 146 Ark. 95, 225 S.W. 330; *Ferguson Lumber Co. v. Scriber*, 162 Ark. 349, 258 S.W. 353; *Whitener v. Purifoy*, 177 Ark. 39, 5 S.W.2d 724; *Standard Lumber Company of Pine Bluff v. Wilson*, 173 Ark. 1024, 296 S.W. 27.

It is stipulated between the parties that the persons entitled to a lien asserted their claims for work and materials furnished by filing with the Circuit Clerk of Desha County, Arkansas, as follows:

Name and Address of Lienor	Period During Which Work and/or Materials Furnished	Date Lien Was Filed	Amount of Lien
1. Blankenship Concrete Co., Inc. McGehee, Arkansas	10- 2-68– 3-11-69	4-19-69	$2,381.43
2. Buren Sharpe Building Material Co., McGehee, Arkansas	10-28-68– 2-13-69	4-26-69	734.02
3. Delbert Creek, McGehee, Arkansas	2-14-69– 3-15-69	4-26-69	996.00
4. A. R. Douglas, t/a Doug's Texaco Station McGehee, Arkansas	12- 4-68–12-31-68	4-26-69	343.53
5. Blankenship Concrete Co., Inc., McGehee, Arkansas	3-11-69– 4-15-69	4-28-69	1,280.45
6. Eddy Valentine, t/a Valentine's Welding Shop, McGehee, Arkansas	11-13-68– 2- 4-69	5-13-69	63.00
7. South Arkansas Oil Co., El Dorado, Ark.	3-15-69– 4-23-69	6- 9-69	925.52

The parties also stipulated as to the amounts owed by Sutton Construction Company, Inc., for materials and labor furnished pursuant to the contracts, together with the amounts owing on the account and the dates that the ma-

terials and labor was furnished. Further, it is stipulated that the plaintiff, Trigg, Switzer and Scott, paid the amounts due the lienholders and the amounts due the creditors.

From the stipulation as to the dates liens by the various parties were filed as related to the dates the labor was performed or materials furnished, each lienor filed an account of the stipulated amount within the 120 days provided by the statute (§51-613).

It follows that since the lienors providing labor and material maintained their right and interest by complying with the statute, the indemnitors became subrogated to that right by paying the claims and, therefore, superior to the claim of the Government to the remaining funds in the amount stated hereinabove.[4]

This opinion includes the findings of fact and conclusions of law, pursuant to Rule 52 of the Federal Rules of Civil Procedure.

An order will be entered in accordance with this opinion.

Dated: June 23, 1971.

OREN HARRIS
United States District Judge

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[4] The Government contends that for the indemnitors to prevail over the lien of the United States the Blanket Indemnity Agreement with the surety, Maryland, was required to be filed to perfect their security interest in accounts or contract rights. The Government relies on the requirements of state law, Ark. Stats. Ann 1947, §§ 85-9-301, 85-9-302. The rights and interest of the lienors are statutory, Ark. Stats. Ann. 1947, § 51-601, et seq. The Uniform Commercial Code, Ark. Stats. Ann. §§ 85-9-101, et seq., does not apply to statutory liens, except as provided in § 85-9-310 (85-9-102 (2)). The exception, § 85-9-310 is not applicable.

In the United States District Court
Western District of Arkansas
El Dorado Division

T. C. Trigg, Ovid Switzer, Victor Scott and First State Bank, Crossett, Arkansas,
Plaintiffs,
vs.
United States of America,
Defendant.
No. ED 69 C-43

JUDGMENT

In accordance with the memorandum opinion filed by this Court on June 23, 1971, accrued interest at the rate of 6 per cent per annum on the sum of $8,336.16 from March 20, 1969, and on the sum of $10,763.59 from April 21, 1969, each to this date, being in the total sum of $2,557.79 to be pro rated to the plaintiffs, judgment is hereby rendered as follows:

It Is, Therefore, by the Court, Considered, Ordered and Adjudged that the First State Bank, Crossett, Arkansas, be and hereby is, awarded judgment against the defendant, United States of America, in the amount of $17,328.87, the judgment to bear interest at the rate of 6 per cent per annum until paid.

It Is, Further, by the Court, Considered, Ordered and Adjudged that T. C. Trigg, Ovid Switzer and Victor Scott be, and hereby are, awarded judgment against the defendant, United States of America, in the amount of $4,328.67, the judgment to bear interest at the rate of 6 per cent per annum until paid.

Dated this 6th day of July, 1971.

OREN HARRIS
United States District Judge

In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-705

FIRST STATE BANK OF CROSSETT, ARKANSAS, PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In August 1967, Sutton Construction Company ("Sutton") executed an accounts receivable security agreement with petitioner. Under this agreement, petitioner was assigned, as security for existing or future loans, all of Sutton's accounts receivable arising during the term of the agreement. However, petitioner did not file its security agreement with the Arkansas Secretary of State or with the Clerk of the Circuit Court, the offices designated by the Arkansas Uniform Commercial Code. See Uniform Commercial Code, Ark. Stat. 1947, Ann. (1961 Addendum), Section 85-9-401(c) (Pet. App. A2-A3). In June 1968, Sutton entered into contracts with the Sewer Im-

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provement District No. 2, McGehee, Arkansas, and the City of Hope, Arkansas, to construct sanitary water and storm sewer improvement facilities (Pet. App. A2). In late 1968, Sutton directed both Arkansas municipalities to make future payments due under the construction contracts payable jointly to petitioner and Sutton. Relying on the security agreement and these written directions, petitioner advanced approximately $15,000 to Sutton to pay for labor and to purchase materials for use in performing the contracts. At the time the present proceeding was instituted, Sutton remained indebted to petitioner in the amount of $13,919.41.

For each taxable period between March 31, 1968, and March 31, 1969, Sutton failed to pay over to the United States employee withholding and F.I.C.A. taxes. Because of this failure, the United States served a notice of levy upon the sewer improvement district of McGehee, Arkansas, and received the sum of $10,763.59, representing progress payments due Sutton for work performed between February 11 and March 1, 1969. Similarly, the United States served a notice of levy upon the City of Hope, Arkansas, and received the sum of $8,336.16, representing progress payments due Sutton for work performed from February 1 to March 7, 1969 (Pet. App. A3).

Petitioner then brought the present suit in the district court, pursuant to Section 7426 of the Internal Revenue Code of 1954, 26 U.S.C. 7426, to recover those progress payments, claiming that they had been wrongfully levied upon by the United States (Pet. App. A15–A16). The district court held that petitioner

as assignee had first priority to the funds and was entitled to $17,328.87 of the amount levied upon by the United States (Pet. App. A19–A28, A33).

The court of appeals, in a thorough opinion on which we rely, reversed, holding that the federal tax liens took priority over the bank's security interest (Pet. App. A4–A10).[1] We add only that, contrary to

[1] There were three competing sets of claimants to the progress payments: (1) the United States, under its liens and levies for Sutton's unpaid payroll taxes; (2) petitioner, under an earlier unrecorded assignment of accounts receivable; and (3) three individuals, T. C. Trigg, Ovid Switzer and Victor Scott, who agreed to indemnify Sutton's surety and who claimed priority as subrogees of mechanic's lienors and as successors in interest to the surety (Pet. App. A1–A2).

Sutton defaulted on its contracts with McGehee and the City of Hope in April 1969, whereupon the surety was called upon to complete performance. The surety, in turn, demanded that the three indemnitors hold it harmless. Pursuant to the surety's demands, the indemnitors paid previously unpaid material and labor claimants and secured a second contractor to complete the projects (Pet. App. A3–A4).

The indemnitors were also plaintiffs in the proceeding against the United States (Pet. App. A15). Since the district court's determination in favor of petitioner did not exhaust the full amount of the progress payments plus interest, the district court also ruled on the relative priorities of the United States and the indemnitors to the remainder of the fund, and awarded second priority to the indemnitors to the balance of the fund in the amount of $4,328.67 (Pet. App. A4, A28–A32, A33). The indemnitors cross-appealed from the district court's determination.

In reversing the district court, the court of appeals held that the United States was entitled to priority over the claims both of petitioner and of the indemnitors and, therefore, was entitled to the total amount of the progress payments. Accordingly, the court did not reach the question of the relative priorities between petitioner and the indemnitors (Pet. App. A4). The indemnitors have not filed a petition for a writ of certiorari.

petitioner's contention, there is no conflict among the courts of appeals. The decision below turns primarily upon a construction of Arkansas law, whereas the decisions cited by petitioner (Pet. 8–9) rested upon the laws of other States. Furthermore, those decisions did not involve the precise issue presented here, for they were concerned with either the validity of a security interest as between the parties to the security agreement or, *In re Halprin*, 280 F. 2d 407 (C.A. 3), the assignment of accounts receivable without even the retention of a right to joint receipt of contract proceeds.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ERWIN N. GRISWOLD,
Solicitor General.

DECEMBER 1972.

U.S. GOVERNMENT PRINTING OFFICE: 1972

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